

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

ANNUAL COMPLIANCE REVIEW, 2021

Docket No. ACR2021

**RESPONSES OF THE UNITED STATES POSTAL SERVICE TO
QUESTIONS 1-6 OF CHAIRMAN'S INFORMATION REQUEST NO. 3**

The United States Postal Service hereby provides its responses to the above-listed questions of Chairman's Information Request No. 3, issued on January 19, 2022.

Each question is stated verbatim and followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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1. Please see Attachment, filed under seal.

RESPONSE:

Please see the response filed under seal as part of USPS-FY21-NP35.

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2. The Postal Service states that “[t]he growing disparity between revenue per piece and cost per piece for First-Class Mail Flats provided the impetus for increasing First-Class Mail Flats prices by 10.3 percent in Docket No. R2021-2 [and that] [t]he Postal Service does not anticipate that revenue per piece and cost per piece will continue to diverge following the latest price increase for First-Class Mail Flats, though the Postal Service will be mindful of 39 C.F.R. 3030.221 in its next price case.” FY 2021 ACR at 9-10.
- a. Please explain in detail why the Postal Service anticipates that revenue per piece and cost per piece will not continue to diverge given that First-Class Mail Flats volume has been declining for more than a decade and this trend has not reversed.
 - b. In addition to compliance with 39 C.F.R. § 3030.221, please provide the Postal Service’s plan to improve the cost coverage of First-Class Mail Flats to bring it to a compensatory level. Please discuss in detail all new actions the Postal Service is taking or planning to take to reduce First-Class Mail Flats attributable costs, as well as any pricing strategy beyond the requirements of 39 C.F.R. § 3030.221 that the Postal Service intends to implement to ensure adequate revenues for the product to cover its attributable costs in future years.

RESPONSE:

a. Please see the response to Question 34, ChIR No. 2, filed on January 25, 2022, which provides the estimated revenue and contribution impact of the 10.3 percent price increase for First-Class Mail Flats implemented on August 29, 2021. The contribution impact of this rate change is estimated to be approximately \$130 million. It is difficult to predict the changes in attributable cost, but, within a plausible range of cost change scenarios, there is a reasonable possibility that the cost coverage will turn positive even with the volume declines included in the forecasting scenario.

b. Besides compliance with 39 C.F.R. § 3030.221, which, under current circumstances, requires a rate increase for First-Class Mail Flats that is two percentage points above the class average, the Postal Service will explore other ways to give Flats

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above-average price increases, subject to workshare and other constraints within the rate design and subject to an overall aim to maximize revenue and contribution at the class level.

The new service standards for First-Class Mail and Periodicals, described in Docket No. N2021-1 and enacted in October 2021, included a transition of mail volume from air transportation to less expensive surface transportation. This change should provide some relief for purchased transportation unit costs for First-Class Flats, which increased by 2.5 cents in FY 2021 compared to FY 2020.

The Postal Service has also established several mail processing initiatives that should alleviate the upward trend in mail processing unit costs. These initiatives are generally structured around shape, rather than around products within a particular shape. It is therefore not feasible to plan for cost reductions specifically targeted at individual products. The broader operational initiatives discussed in the narrative accompanying USPS-FY21-45 paragraph (f) include the plans the Postal Service has established to reduce attributable costs for flat-shaped products, which include First-Class Mail Flats.

Some of the initiatives described include FSS delivery point compression, equipment right sizing, pilot opportunities and site-specific flats operating plans.¹ In early FY 2021, the Postal Service network faced issues related to mail processing and transportation capacity, causing both mail processing and transportation costs to

¹ See USPS-FY21-45 Rule 3050.50, Paragraph (f) -- Operational Changes Report

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increase. In the latter portion of FY 2021, the Postal Service was able to increase capacity, improve service, and relieve the upward pressure on costs.

Greater increases in unit revenue because of above-average increases in price in conjunction with cost-controlling initiatives will hopefully result in increases in contribution and cost coverage in FY 2022 and future fiscal years.

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3. In discussing USPS Marketing Mail Carrier Route, the Postal Service states that “[t]he decline in cost coverage appears, in large part, to be driven by the changing Commercial and Nonprofit mail mix.” FY 2021 ACR at 17. The Postal Service further states that “[t]his mail mix change has blunted the price increases that the Postal Service has recently given Carrier Route.” *Id.* at 18. In addition, the Postal Service states that “[w]hile Flats volume decreased by 330 million pieces, or 10.3 percent, with the volume distribution among presort and entry levels remaining similar to last year, the effect of the price increases on Flats cost coverage was to some degree offset by a change in Commercial versus Nonprofit mail mix.” *Id.* at 20.
- a. Please confirm that the change in mail mix is the single most important factor responsible for the cost coverage decline in FY 2021. If not confirmed, please discuss other factors in detail, rank them in order of relevance, and provide the reasons for the ranking.
 - b. Please confirm that the Postal Service anticipates the discussed change in volume mix between Commercial and Nonprofit mail to be temporary.
 - i. If confirmed, please discuss whether this change in volume mix will result in any meaningful improvement to the USPS Marketing Mail Flats cost coverage in the long term.
 - ii. If not confirmed, please discuss all remedial action(s) that the Postal Service is undertaking to prevent future increases in Flats cost coverage from being offset by changes in Commercial versus Nonprofit mail mix.

RESPONSE:

a. Partially confirmed. The mail mix change between Commercial and Nonprofit is the single most important factor for the cost coverage decline between FY 2020 and FY 2021 for Carrier Route and a secondary contributor for Marketing Mail Flats. Between those two fiscal years, the Carrier Route cost coverage declined from 96.0 percent to 94.5 percent, and the Marketing Mail Flats cost coverage declined from 63.2 percent to 60.2 percent. By holding the Nonprofit and Commercial mail mix constant (in a scenario analysis), the Postal Service calculates that the change in this mail mix

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accounted for 77.7 percent of the Carrier Route cost coverage decline and 36.4 percent of the Marketing Mail Flats cost coverage decline. The primary cause of the cost coverage decline for Carrier Route was, therefore, the increase in the Nonprofit mail share of total volume (from 9.0 percent to 12.5 percent). A secondary cause was the unit cost increase, 3.5 percent, which exceeded the increase in unit revenue of 1.9 percent.

For Marketing Mail Flats, the primary cause was the unit cost increase, 8.0 percent, which exceeded the increase in unit revenue, 3.0 percent. The adverse change in the mail mix was only a secondary cause.

b. Not confirmed for Marketing Mail Flats. The Postal Service is uncertain about Carrier Route. Table 1, below, displays the trend in the share of Nonprofit volume between FY 2015 and FY 2021 for Marketing Mail Flats and Carrier Route. For Marketing Mail Flats, the share of Nonprofit volume has increased steadily, which does not suggest that the mail mix changes are temporary.

The upward trend in the Nonprofit share for Carrier Route is not as pronounced, although the Nonprofit shares for Carrier Route for the past three years are discernibly higher than for the previous four years.

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**Table 1:
Nonprofit Share of Volume for Marketing Mail Flats and Carrier Route
(FY 2015 – FY 2021)**

FY	Product	Volume (Millions)			Volume Distribution (%)	
		Commercial	Nonprofit	Total	Commercial	Nonprofit
2015	MM Flats	4,100	1,145	5,245	78.2%	21.8%
2016	MM Flats	5,093	1,212	6,305	80.8%	19.2%
2017	MM Flats	3,800	1,144	4,944	76.9%	23.1%
2018	MM Flats	3,012	1,067	4,079	73.8%	26.2%
2019	MM Flats	2,743	1,076	3,819	71.8%	28.2%
2020	MM Flats	2,270	929	3,199	71.0%	29.0%
2021	MM Flats	1,944	926	2,870	67.7%	32.3%
2015	MM Carrier Route	7,636	655	8,291	92.1%	7.9%
2016	MM Carrier Route	6,185	458	6,643	93.1%	6.9%
2017	MM Carrier Route	6,563	570	7,133	92.0%	8.0%
2018	MM Carrier Route	6,517	518	7,035	92.6%	7.4%
2019	MM Carrier Route	5,760	599	6,359	90.6%	9.4%
2020	MM Carrier Route	4,595	452	5,047	91.0%	9.0%
2021	MM Carrier Route	4,410	631	5,041	87.5%	12.5%

i. Focusing in isolation on the effects of mail mix changes between Commercial and Nonprofit on the cost coverage for Flats, meaningful improvements over the long term would require an actual reversal of recent trends. In other words, the Nonprofit portion would have to diminish. Given actual recent trends, the Nonprofit share seems much more likely to increase, or perhaps merely remain at recent higher levels.

ii. The Postal Service is exploring possible remedial actions. Within the applicable legal constraints, the primary plan is to give relatively larger price increases to Nonprofit Carrier Route and Marketing Mail Flats.

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4. Please refer to the discussion on the Commission Flats Directive in the FY 2021 ACR where the Postal Service states that “[g]oing forward, the Postal Service intends to continue complying with 39 C.F.R. § 3030.221. Therefore, the Postal Service’s schedule of future price increases is that Flats prices will increase at least 2 percentage points above the USPS Marketing Class average in each Market Dominant price case until such time as either there is significant cost coverage improvement so that Flats is no longer subject to Rule 3030.221 or the Commission otherwise revises its pricing directive.” *Id.* at 32-33.
- a. In addition to compliance with 39 C.F.R. § 3030.221, please provide the Postal Service’s plan to improve the cost coverage of USPS Marketing Mail Flats to bring it to a compensatory level.
 - b. Please discuss in detail all new actions the Postal Service is taking or planning to take to reduce USPS Marketing Mail Flats attributable costs, as well as any pricing strategy beyond the requirements of 39 C.F.R. § 3030.221 that the Postal Service intends to implement to ensure adequate revenues for the product to cover its attributable costs in future years.

RESPONSE:

a. and b. Cost coverage is impacted by two factors: revenue and attributable cost. In order to improve cost coverage, one or both factors must be addressed. In FY 2021, Marketing Mail Flats unit revenue increased by 1.2 cents (3 percent) compared to the previous year.

The unit attributable cost increased by 5.3 cents (8.0 percent) during this same period, which was primarily driven by a 2.5-cent (11.7 percent) increase in delivery unit costs, a 2.1-cent (5.4 percent) increase in mail processing unit costs, and a 0.8-cent (16.8 percent) increase in purchased transportation unit costs.

The Postal Service understands the impact of increasing costs on cost coverage. Operations are generally structured around shape, rather than around products within a particular shape. It is therefore not feasible to plan for cost reductions specifically

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targeted at individual products. The broader operational initiatives discussed in the narrative accompanying USPS-FY21-45 paragraph (f) include the plans the Postal Service has made to reduce attributable costs for flat-shaped products, which include Marketing Mail Flats.

Some of the planned Postal Service initiatives to reduce flats costs include FSS delivery point compression, equipment right sizing, pilot opportunities and site-specific flats operating plans.² In early FY 2021, the Postal Service network faced issues related to mail processing and transportation capacity which resulted in increasing costs. In the latter portion of FY 2021, the Postal service was able to increase capacity and improve efficiency.

Greater increases in unit revenue because of above-average increases in price in conjunction with cost-controlling initiatives will hopefully result in increases in contribution and cost coverage in FY 2022 and future fiscal years.

² See USPS-FY21-45 Rule 3050.50, Paragraph (f) -- Operational Changes Report

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5. When describing the Automated Flats Sorting Machine 100, the Postal Service states that “[b]ecause setup and breakdown activities are largely invariant to processed volume, the continued volume declines necessarily lead to higher unit mail processing costs.” *Id.* at 20.
- a. Please provide an estimate of the “setup and breakdown activities” costs as a proportion of mail processing costs for all flat-shaped mail pieces in FY 2015 through FY 2021.
 - b. Using distribution keys and entry point assumptions³ from Library Reference USPS-FY21-11, please provide an estimate of “setup and breakdown activities,” disaggregated by product, for FY 2015 through FY 2021.

RESPONSE:

a. IOCS activity data provide estimates for costs of AFSM100 “setup and breakdown activities” as a proportion of the total costs associated with the AFSM100 mail processing cost pool. These data are summarized in Table 2 below.

**Table 2:
Setup / Breakdown Costs
As a Percentage of AFSM100 Mail Processing Costs**

Fiscal Year	Percentage
2015	5.72%
2016	5.76%
2017	5.77%
2018	6.19%
2019	6.56%
2020	7.15%
2021	6.14%

b. The methodology from USPS-FY21-11 cannot be used to develop setup and breakdown cost estimates specific to each product. Given that the Commission’s

³ See Library Reference USPS-FY21-11, December 29, 2021, Excel file “USPS-FY21-11 MM & CR.xlsx,” tab “MADC NONAUTO MODEL,” cells A11:O16.

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accepted methodology treats setup and breakdown costs as volume variable, the Postal Service believes that the best available estimates of AFSSM100 setup and breakdown cost shares for each product are the cost pool (aggregate) shares reported in the response to part a.

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6. The Postal Service states that “[c]ost coverages for the Periodicals class overall decreased from 56.92 percent in FY 2020 to 53.24 percent in FY 2021.” *Id.* at 38.
- a. In addition to compliance with 39 C.F.R. § 3030.221, please provide the Postal Service’s plan to improve the cost coverage of Periodicals and bring it to a compensatory level.
 - b. Please discuss in detail all new actions the Postal Service is taking or planning to take to reduce Periodicals attributable costs, as well as any pricing strategy beyond the requirements of 39 C.F.R. § 3030.221 that the Postal Service intends to implement to ensure adequate revenues for the product to cover its attributable costs in future years.

RESPONSE:

a. and b. Cost coverage is impacted by two factors: revenue and attributable cost. In order to improve cost coverage, one or both factors must be addressed. In FY 2021, the Periodicals unit attributable cost increased 3.2 cents (7.2 percent) and was primarily driven by a 1.5-cent (7.6 percent) increase in delivery unit costs, a 1.4-cent (7.2 percent) increase in mail processing unit costs, and a 0.8-cent (19.1 percent) increase in unit transportation costs.

The Postal Service understands the impact of increasing costs on cost coverage. Operations are generally structured around shape, rather than around products within a particular shape. It is therefore not feasible to plan for cost reductions specifically targeted at individual products. The broader operational initiatives discussed in the narrative accompanying USPS-FY21-45 paragraph (f) include the plans the Postal Service has made to reduce attributable costs for flat-shaped products, which include Periodicals.

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Some of the planned Postal Service initiatives to reduce flats costs include FSS delivery point compression, equipment right sizing, pilot opportunities and site-specific flats operating plans.⁴ In early FY2021, the Postal Service network faced issues related to mail processing and transportation capacity which resulted in increasing costs. In the latter portion of FY 2021, the Postal service was able to increase capacity and improve efficiency.

In addition to these initiatives, the new service standards for First-Class Mail and Periodicals, described in Docket No. N2021-1 and enacted in October 2021, included a transition of mail volume from air transportation to less expensive surface transportation. This initiative should provide some relief for purchased transportation unit costs for Periodicals, which increased by 0.8 cents (19.1 percent) in FY 2021 compared to FY 2020.

The Postal Service also plans to improve operational efficiency by providing price signals to customers in preparing their mail in containers like pallets that are less expensive for the Postal Service to handle and process.

Greater increases in unit revenue because of above-average increases and other pricing initiatives described above, in conjunction with cost-controlling initiatives, will hopefully result in increases in contribution and cost coverage in FY 2022 and future fiscal years.

⁴ See USPS-FY21-45 Rule 3050.50, Paragraph (f) -- Operational Changes Report